

**BILL #** SB 1152

**TITLE:** sales tax holiday; educational supplies

**SPONSOR:** Martin

**STATUS:** As Amended by Senate Finance and Rules

**PREPARED BY:** Jake Corey and Leatta McLaughlin

## **FISCAL ANALYSIS**

### **Description**

As amended, the bill would exempt from the state and municipal Transaction Privilege Tax (TPT) school related art supplies, clothes, computers (not to exceed a cost of \$1,000), computer supplies, and instructional materials that are purchased between August 1 and August 7 each year. The bill would require municipalities to participate in the sales tax holiday unless an exemption is approved by a 2/3 majority vote by the governing board or an initiative or referendum vote. The bill also allows a K-12 teacher to directly offset individual income tax liability by an amount of unreimbursed educational supplies and materials up to \$250 per year, and to deduct from their income the amount spent on those supplies and materials greater than \$250. The bill becomes effective from and after December 31, 2006.

### **Estimated Impact**

Beginning in FY 2008, the bill is estimated to reduce General Fund revenues collections by \$(16.8) million to \$(21.1) million. There are two components to this cost estimate. First, the tax holiday provisions of the bill would reduce General Fund sales tax revenues by between \$(2.2) to \$(6.5) million annually, depending on the extent to which consumers take advantage of the holiday.

Second, the bill would reduce General Fund individual income revenues by up to \$(14.6) million annually if every K-12 teacher in the state took advantage of the direct income tax offset by the maximum allowable amount of \$250. A further revenue loss could result from the provision allowing teachers to claim an additional income deduction. The actual decrease in revenues will depend on the degree to which teachers take advantage of these provisions.

The Arizona Department of Revenue (DOR) estimates the sales tax holiday would reduce General Fund revenues by \$(2.2) million. The department estimates that the \$250 teacher income tax offset and deduction would reduce General Fund revenues by between \$(10.4) and \$(13.4) million.

### **Analysis**

#### Sales Tax Holiday

The bill would exempt from the sales tax school related art supplies, clothing, computers (up to \$1,000), computer supplies, and instructional materials and supplies purchased between August 1-7 of each year.

The impact of the holiday would depend on consumer spending on exempt items during the holiday. The Department of Revenue estimates that the exempt items would generate \$60 million in sales during the holiday. Based on this level of sales, the total annual General Fund revenue loss would be \$(2.2) million.

Data from the U.S. Department of Commerce's Bureau of Economic Analysis (BEA), however, suggest that sales of exempt items may be higher than the level projected by DOR. Nationwide, BEA reports total sales of \$439.4 billion in 2004 on items that would become exempt under the bill, including \$51.0 billion for computers, \$41.1 billion for books, \$329.0 billion for clothing, and \$18.3 billion for school supplies. Using the national figures to project Arizona sales of exempt items during the proposed holiday, total sales of exempt items are estimated to be \$176.2 million, including \$20.4 million for computers, \$16.6 million for books, \$131.9 million for clothing, and \$7.3 million for school supplies. The total projected sales of exempt items excludes the potential impact on consumer purchases, which could increase as a result of offering the holiday. Based on the \$176.2 million level of sales, the total annual General Fund revenue loss would be \$(6.5) million.

As a point of comparison, South Carolina has an existing 3 day sales tax holiday which is annually held over the first weekend in August. The South Carolina Department of Revenue, which collects information from businesses on sales of exempt items during the holiday, reports that in FY 2005 the holiday resulted in a total revenue loss of \$(2.6) million in that state. Applying the South Carolina figures to Arizona, and adjusting for differences in population and the tax rate, the total expected revenue loss in Arizona would be \$(4.1) million, of which \$(2.7) million would be from the General Fund. There would be a greater incentive, however, for Arizona consumers to take advantage of a holiday as the combined state and local sales tax rates are higher in Arizona than in South Carolina.

In addition to its impact on the General Fund, the sales tax holiday would reduce funding for Proposition 301 education initiatives. The total annual revenue loss for these initiatives is estimated to be between \$(360,000) and \$(1.1) million.

Even though state revenue would decrease during the tax holiday, other states that practice similar back-to-school sales tax holidays have experienced higher sales of non-exempt items during the tax holiday window, which has led to higher revenue collections for non-exempt purchases.

#### Teacher Income Tax Offset and Deduction

The bill would allow teachers to offset their Arizona individual income tax up to \$250 for the cost of teaching supplies and materials that were not reimbursed by their school. There are currently about 58,500 K-12 teachers in Arizona. If all teachers in the state were to take advantage of the maximum \$250 offset, there would be a \$(14.6) million decrease in individual income tax collections. The bill also allows teachers to deduct from their Arizona income the amount spent on supplies and materials greater than \$250, which could result in a further decrease in individual income tax collections.

The actual impact of these provisions will depend on the extent to which teachers take advantage of the offset and deduction. Based on school district data contained in the FY 2005 Annual Report for the Arizona Department of Education, the average annual salary of an Arizona teacher is about \$45,000. The average Arizona income tax liability resulting from this level of income would be approximately \$600. Most teachers, therefore, would have sufficient liability to take advantage of these provisions.

#### **Local Government Impact**

TPT revenues are shared with local governments and any reduction in these collections would result in decreased funding for local governments. The proposal would reduce the city and county share of the state sales tax by between \$(786,100) and \$(2.3) million per year.

Besides the tax at the state level, the cities and counties assess their own individual sales tax. This legislation would exempt consumers from the local tax unless either of the following 2 items occurs: 1) an ordinance is adopted by a 2/3 majority vote of the governing board or 2) an initiative or referendum is adopted by the voting population of the municipality. If municipalities participate in the sales tax holiday, there would be a further loss of local revenues.

Regarding the provisions related to teacher income taxes, the Urban Revenue Sharing formula distributes 15% of income taxes collected two years prior to incorporated cities and towns. The \$250 direct tax offset, therefore, could reduce the distribution of these revenues by up to \$2.2 million beginning in FY 2009. The income tax deduction provision could result in a further loss of local revenues.